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Item 3 (j) of the provisional agenda

Tax treatment of official development assistance (ODA) projects – Revised Guidelines on the Tax Treatment of ODA Projects

Note by the Subcommittee on the Tax treatment of ODA Projects

Summary

This note, which is presented for discussion (and not for approval) at the twentieth session of the Committee, includes a revised version of the Guidelines on the Tax Treatment of ODA projects that were discussed at the eighteenth and nineteenth session.

This revised version was prepared by the Subcommittee on the Tax Treatment of ODA Projects on the basis of the discussions at these earlier sessions and in light of the written comments submitted on the previous version of the Guidelines. These comments were discussed at the Subcommittee's second meeting held in Paris on 6-7-8 February 2020.

At its twentieth session, the Committee is invited to discuss the attached revised Guidelines. The Committee is also invited to approve the publication of the revised Guidelines as a discussion draft on which interested stakeholders will be able to send written comments, by email to the Secretariat at taxcommittee@un.org, **before 15 August 2020**.

1. At the seventeenth session of the Committee (Geneva, 16-20 October 2018), the Committee decided that further work on the issue of the tax treatment of ODA projects should be carried out by a new Subcommittee on the Tax Treatment of Official Development Assistance (ODA) Projects, which was given the following mandate:

> The Subcommittee is mandated to address the issues arising from the tax treatment of ODA projects and, in particular, to update and finalize the 2007 Draft Guidelines on the Tax Treatment of ODA projects that were attached to note E/C.18/2018/CRP.5, taking into account, among other things, the annotations included in that document and the written comments sent by Committee members. In carrying on that work, the Subcommittee shall
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> - Pay special attention to the experience of developing countries and of governmental and inter-governmental donor agencies.
> - Ensure that its work draws upon and feeds into, as appropriate, the relevant work on the issue done in other fora, especially the Platform for Collaboration on Tax.
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> The aim of the Subcommittee shall be to present to the Committee a revised version of the 2007 Draft Guidelines for consideration with a view to their adoption at the first meeting of the Committee in 2020. Updates on the progress of the work shall be provided to the Committee at each preceding session. The Subcommittee may request the Secretariat to develop necessary inputs and provide necessary support within its resources.

2. At is eighteenth session (New York, 23-26 April 2019) and nineteenth session (Geneva, 15-18 October 2019), the Committee discussed a first draft of the revised Guidelines which took account of the decisions taken at the Subcommittee's first meeting held in London on 10-11-12 March 2019.

3. Based on these discussions and after having discussed each of the written comments submitted on the first draft of the revised Guidelines at its second meeting held in Paris on 6-7-8 February 2020, the Subcommittee produced the attached revised version of the Guidelines.

4. In addition to addressing a number of technical issues, the extensive changes made to the Guidelines deal with a number of concerns that were previously raised. For instance:

- The non-binding character of the Guidelines has been emphasized in response to a number of comments to that effect. In particular, the new version avoids what was perceived by some to be a commitment by developing countries to follow some internationally-agreed taxation principles.
- While the previous version of the Guidelines used the 183-day period as a proxy for the concept of permanent establishment, the new version merely refers to the proposed definition of permanent establishment found in the UN and OECD models.
- The new version makes a clear distinction between the Guidelines themselves and the internationally-agreed taxation principles which are referred to in the Guidelines. In doing so, it avoids presenting these internationally-agreed taxation principles as rules that need to be followed by recipient countries.
- The new version clarifies that the Guidelines do not affect in any way the application of the rules of any relevant tax treaty, thereby addressing a request that the relationship between the Guidelines and tax treaties be better explained.

5. At its twentieth session, the Committee is invited to discuss the attached revised Guidelines. The Committee is also invited to approve the publication of the attached draft

Guidelines as a discussion draft on which interested stakeholders will be able to send written comments, by email to the Secretariat at taxcommittee@un.org, **before 15 August 2020**.

6. The Subcommittee intends to meet again before the twenty-first session of the Committee in order to revise the Guidelines in light of the comments received so that a final version maybe presented for final discussion and approval at the Committee's twenty-first session.

GUIDELINES ON THE TAX TREATMENT OF ODA PROJECTS

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Executive Summary

The practice of granting tax exemptions with respect to official development assistance (ODA) projects is widespread among developing countries. A recent survey shows that such exemptions are most often provided with respect to value-added taxes, customs duties as well as corporate taxes, personal income taxes and payroll taxes, including taxes withheld at source. There are no reliable estimates of the overall tax revenues foregone through such exemptions.

The Addis Ababa Action Agenda, which includes a comprehensive set of measures aimed at addressing the challenges of financing the 2030 Sustainable Development Goals, includes a commitment to "consider not requesting tax exemptions on goods and services delivered as government-to-government aid, beginning with renouncing repayments of value-added taxes and import levies."

This note includes a set of Guidelines that were developed by the United Nations Committee of Experts on International Cooperation in Tax Matters in light of this commitment. The Guidelines seek to facilitate the consideration of whether or not tax exemptions should be requested with respect to ODA projects and, if tax exemptions are requested, how they should be negotiated and implemented.

These Guidelines recognize that while each donor is free to establish the conditions under which it is willing to provide ODA, it should recognize that tax exemptions create significant difficulties for developing countries and run counter to the objective of strengthening domestic resource mobilization.

The Guidelines deal exclusively with the tax treatment of projects involving development assistance provided by governments and their aid agencies, including assistance provided through international governmental organizations. They make reference to a number of existing internationally-recognized tax principles that are reflected in multilateral instruments as well as in the network of bilateral tax treaties and explain how compliance with these principles ensures that no tax will typically be levied with respect to a number of transactions taking place in the context of an ODA project without the need for negotiated tax exemptions. While the Guidelines refer to these internationally-agreed principles, they do not provide tax rules that donors or recipient countries would be expected to follow or include in agreements.

The Guidelines are not binding in any way and are drafted in general terms to facilitate their understanding by people who have limited tax expertise. They have been prepared for purposes of assisting donors and developing countries in determining the appropriate tax treatment of ODA projects. The Guidelines should facilitate the discussion of tax issues between donors and recipients of ODA. Hopefully, they will contribute to avoiding a proliferation of different rules, which would reduce transparency and increase the administrative and compliance burden of both donors and recipients. Since some donors already follow the policy of not requesting tax exemptions for their ODA projects, the Guidelines will also promote a greater consistency in this area, thereby reducing situations where the tax administration of a developing country

must administer different tax rules with respect to two or more donors, often for their participation in the same development project or with respect to the respective contributions of donors and the private sector to the same development project carried out under a public-private partnership arrangement.

The Guidelines first deal with general considerations relevant to the issue of whether tax exemptions should be granted with respect to ODA projects. Guideline 1 is aimed at donors: it encourages them to refrain from requiring exemptions from the taxes levied in recipient countries with respect to transactions relating to ODA projects, except to the extent that, and only as long as, the tax rules in the recipient country that would apply to these transactions are not consistent with internationally-agreed tax principles or in exceptional cases where serious concerns with the payment of tax to that country result from a review of the governance structure, tax system or tax administration of that country. Guideline 2 is aimed at recipient countries and encourages them to ensure that their tax treatment of transactions relating to ODA projects is consistent with internationally-agreed tax principles in order to reduce situations in which specific tax exemptions with respect to ODA projects might be requested.

The Guidelines then address cases where it is decided that specific exemptions should be requested for ODA projects. In that case, the Guidelines suggest that the tax authorities should be involved in the negotiation and drafting of these exemptions and that the scope of these exemptions be restricted to the donors so that they do not apply to other parties such as subcontractors and consultants. The Guidelines also deal with the transparency of country policies concerning the payment of taxes related to ODA projects and the need to ensure that the relevant parts of any document providing for such exemptions are made publicly available. The other Guidelines deal with the implementation of negotiated tax exemptions. They encourage recipient countries to ensure that all legal requirements necessary to give force of law to these exemptions are satisfied and also stress the importance of forecasting, and doing an analysis of, the foregone tax revenues resulting from these tax exemptions as well as using mechanisms that minimise administrative burdens and reduce fraud in relation to the application of these exemptions. Regardless of whether or not tax exemptions for transactions related to ODA projects are granted, the Guidelines also recommend that donors comply with the information and withholding tax requirements of recipient countries with respect to payments to taxable entities.

The Guidelines are followed by a description of some of the internationally-recognised principles to which they refer. These principles deal with the following:

- Income taxation – employment remuneration
- Income taxation – profits and payments to foreign enterprises
- Indirect taxation – humanitarian crises
- Indirect taxation – personal property and household goods of workers
- Indirect taxation – temporary admission

The description of these internationally-recognized principles is followed by detailed explanations of the Guidelines that include a summary of the pros and cons of tax exemptions for ODA projects as well as a discussion of each of the Guidelines. Explanations are also provided with respect to each of the internationally-recognized principles referred to in the Guidelines.

INTRODUCTION

1. The *Addis Ababa Action Agenda*, [1] which was endorsed by the UN General Assembly in its 2015,[2] includes a comprehensive set of concrete actions in order to address the challenges of financing and creating an enabling environment for the achievement of the 2030 Sustainable Development Goals. One of these actions deals with tax exemptions related to government-to-government assistance:

> We will also consider not requesting tax exemptions on goods and services delivered as government-to-government aid, beginning with renouncing repayments of value-added taxes and import levies.[3]

2. The Guidelines included in this note were developed by the United Nations Committee of Experts on International Cooperation in Tax Matters in order to facilitate the consideration of whether or not tax exemptions should be requested with respect to international assistance projects and, if tax exemptions are requested, how they should be negotiated and implemented.

3. International assistance may be provided to a country by foreign governments, government-controlled agencies, international organizations, non-governmental organizations (NGOs), companies or individuals. Such assistance may be designed to facilitate development or reform, may respond to natural disasters or other humanitarian crises, may take the form of peacekeeping operations, or may advance other development or welfare purposes. It may take different forms, such as grants, concessional loans and goods or services provided in kind. It may result from bilateral or multilateral assistance projects. These Guidelines, however, apply exclusively to international assistance that is provided to a country or jurisdiction by the government of a foreign country (or its subdivisions or agencies) either directly or through a multilateral development institution. This corresponds to the concept of official development assistance (ODA),[4] which is the term generally used in these Guidelines.

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1 United Nations, *Addis Ababa Action Agenda of the Third International Conference on Financing for Development (Addis Ababa Action Agenda)*, final text of the outcome document adopted at the Third International Conference on Financing for Development (Addis Ababa, Ethiopia, 13–16 July 2015).

2 Resolution 69/313 of 27 July 2015.

3 *Addis Ababa Action Agenda,* section C (International Development Cooperation), paragraph 58.

4 The concept of Official Development Assistance (ODA) was developed by the OECD Development Assistance Committee (DAC) for the purposes of measuring government-to-government assistance flows. The OECD provides the following general definition of ODA:

> ODA is the resource flows to countries and territories on the DAC List of ODA Recipients (http://oe.cd/dac-list) and to multilateral development institutions that are:
>
> i. Provided by official agencies, including state and local governments, or by their executive agencies; and
>
> ii. Concessional (i.e. grants and soft loans) and administered with the promotion of the economic development and welfare of developing countries as the main objective.

The OECD also clarifies that ODA does not include "military aid and promotion of donor's security interests" as well as assistance provided for "primarily commercial objectives e.g. export credits" (see OECD, *What is ODA?*, at http://www.oecd.org/dac/financing-sustainable-development/development-finance-standards/What-is-ODA.pdf).

4. Tax[5] exemptions for various transactions under ODA projects are granted by many developing countries, typically at the insistence of donors. The following are examples of situations where these exemptions could apply:

- Goods are imported by a non-resident on a temporary basis (possible exemption from customs duties, VAT and other indirect taxes);
- Goods are imported by a non-resident, but will not be re-exported (possible exemption from customs duties and VAT);
- Goods are imported by a resident, to be paid for using project funds (possible exemption from customs duties and VAT);
- Goods or services are purchased from a local supplier, using project funds (possible exemption from VAT);
- A non-resident individual comes to the country to provide services as an employee to be paid for using project funds (possible exemption from individual income tax and social contributions);
- A non-resident contractor provides services under a contract financed with project funds (possible exemption from income or corporate tax);
- A resident company (or a non-resident having a permanent establishment in the country) is hired to provide services to be financed using project funds (possible exemption from income or corporate tax);
- Resident individuals are hired to work for a resident or non-resident contractor with project funds (possible exemption from individual income tax and social contributions).

5. A publication of the African Tax Administration Forum, *The Taxation of Foreign Aid – Don't ask, Don't tell, Don't know*[6] includes a list of common ODA exemptions[7] and shows the extent to which the practice of granting tax exemptions with respect to ODA projects is widespread among developing countries. That publication, which reports the results of a survey of 20 developing countries (including 15 from sub-Saharan Africa), indicates that nearly all these countries (95%) provide tax exemptions for ODA with respect to value-added taxes while 85% provide tax exemptions with respect to customs duties and around 60% with respect to corporate taxes, personal income taxes and payroll taxes, including taxes withheld at source.[8] The survey also indicates that in most countries, there are no published estimates of the tax revenues impacted by these exemptions.[9] Another study by Caldeira, Geourjon and Rota-

5 In these Guidelines, references to "tax exemptions" cover exemptions from domestic taxation as well as exemptions from customs duties. These exemptions refer to any form of relief, whether total or partial. Also, references to indirect taxes generally refer to value-added taxes (VAT), goods and service taxes (GST) as well as broadly-based or specific sales and consumption taxes, including excise taxes

6 African Tax Administration Forum, *The Taxation of Foreign Aid – Don't ask, Don't tell, Don't know,* May 2018.

7 Id. Table 1, p. 10.

8 Id. p. 5.

9 Id, p. 15.

Graziosi,[10] however, estimates that for some African countries, the amount of these tax revenues could be as high as 1% to 2% of the GDP of these countries.

6. Domestic laws and existing international instruments often provide for certain tax exemptions without the need for a specific exemption for ODA projects. For example, a non-resident importing goods which will be taken out of the country after being used for a project might qualify under the terms of a general customs regime for temporary imports. Also, a non-resident which provides services paid by a foreign donor without having a permanent establishment in the developing country where the work is carried on might not be subject to income or corporate taxes under the income tax legislation of that country or under the terms of a generally applicable tax treaty, again without specific reference to the ODA project.

7. Each donor is of course free to establish the conditions under which it is willing to provide ODA. Some donors may be concerned that the imposition of taxes would decrease resources available for their development activities and that it would be difficult to rally domestic support for payment of taxes. As further explained below they may consider that if their budget for financing foreign aid is limited, funding the payment of taxes to a developing country in relation to a development project in that country would simply decrease the amount available for funding the other costs of the project (see paragraphs 16 and 22 below).

8. Donors should recognize, however, that the issue of granting tax exemptions with respect to a development project is not a zero-sum game where a developing country receives the same of amount of foreign aid either in the form of taxes paid or in the form of additional goods or services provided through the project. Tax exemptions have important spillover costs that result from the economic distortions, the significant administrative difficulties and the tax avoidance and tax abuse risks that they generate for developing countries.

9. Tax exemptions also run counter to the objective of strengthening domestic resource mobilisation. One of the four principles for strengthening the effectiveness of development cooperation that were endorsed in 2011 by 161 countries through the Busan Partnership for Effective Development Co-operation is that co-operation "investments and efforts must have a lasting impact on eradicating poverty and reducing inequality, on sustainable development, *and on enhancing developing countries' capacities, aligned with the priorities and policies set out by developing countries themselves"* [emphasis added].[11] While developing countries would rightly be concerned if the payment of taxes with respect to development projects were to reduce the total amount of foreign aid that they would receive, their views should be taken into account when the real question is whether a given amount of foreign aid should either be allocated exclusively to funding the costs of goods or services directly provided through these development projects or should also be allocated in part to the payment of normal taxes associated to the provision of these goods or services. Given the spillover costs resulting from the granting of tax exemptions, developing countries will typically prefer that part of the aid that they receive be used to fund the payment of these taxes. This is a legitimate policy choice that should be taken into account by donors.

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10 Caldeira, E, Geourjon, A-M and Rota-Graziosi, G, "Taxing aid: the end of a paradox?" published in *International Tax and Public Finance* (2020) 27:240-255 available at https://doi.org/10.1007/s10797-019-09573-6.

11 Communiqué of the *Busan Partnership for Effective Development Co-Operation – Fourth High Level Forum on Aid Effectiveness*, Busan, Republic of Korea, 29 November-1 December 2011, paragraph 11, available at https://www.oecd.org/dac/effectiveness/49650173.pdf.

10. Donor countries, their aid agencies and the international organizations through which ODA is provided to a country are therefore encouraged to refrain from requesting exemptions from tax for transactions relating to ODA projects in that country except to the extent that, and only as long as, the rules in the recipient country for taxing ODA-related transactions fail to comply with internationally recognized tax principles or in exceptional cases where serious concerns with the payment of tax to that country result from an objective review of the governance structure, tax system or tax administration that country.

SCOPE AND PURPOSES OF THE GUIDELINES

11. The Guidelines deal exclusively with the tax treatment of ODA provided by governments (including governments of political subdivisions and local governments) or their agencies, whether the ODA is provided directly or through international organizations (these governments, agencies and international organizations being collectively referred to as "donors"). Private assistance provided directly by NGOs, raises a distinctive set of issues and is therefore not addressed in these Guidelines. Also, to the extent that a project involves public and private funding, the Guidelines only apply to the extent that the public funding constitutes ODA.

12. The Guidelines refer expressly to a number of existing international tax principles that are reflected in multilateral instruments as well as in the network of bilateral tax treaties based on the OECD and UN Model Tax Conventions. The Guidelines' starting point is that to the extent that these principles already apply to the tax treatment of transactions related to ODA projects, there is no need for negotiated tax exemptions.

13. The Guidelines have been prepared for purposes of assisting donors and recipient countries in determining the appropriate tax treatment of ODA projects. The Guidelines are intended to facilitate the discussion of tax issues between donors and recipients of ODA. Hopefully, they will avoid a proliferation of different rules, which would reduce transparency and increase the administrative and compliance burden of both donors and recipients. Since some donors already follow the policy of not requesting tax exemptions for their ODA projects, the Guidelines will also promote a greater consistency in this area, thereby reducing situations where the tax administration of a developing country must administer different tax rules with respect to two or more donors, often for their participation in the same development project or with respect to the respective contributions of donors and the private sector to the same development project carried out under a public-private partnership arrangement.

14. Although these Guidelines are intended to be prospective, donors and recipient countries are encouraged to review existing agreements in the light of the Guidelines.

15. As already mentioned, the Guidelines are not binding in any way and are drafted in general terms to facilitate their understanding by people who have limited tax expertise. While they refer to some internationally-agreed principles, they do not provide tax rules that donors or recipient countries would be expected to follow or include in agreements. To the extent that the internationally-agreed principles referred to in the Guidelines are already reflected in the domestic laws of recipient countries or in relevant treaties (including tax treaties) concluded by these countries, the assumption is that there is no need to confirm their application in in any legally binding instruments. It is recognized, however, that the existing network of tax treaties is far from comprehensive, especially as regards developing countries, and that a large number of countries are not yet parties to the multilateral instruments in the field of indirect taxes that are referred to in these Guidelines. If a recipient country that is not party to such instruments

wished to ensure unilaterally that the tax treatment of ODA projects conformed with these principles, it could do so through its domestic tax laws. Alternatively, it could do so through provisions included in bilateral instruments concluded with donors that would be given force of law in that country.

GUIDELINES

Basic principles concerning requests for tax exemptions for ODA projects

1. Donor countries, their aid agencies as well as international governmental organizations through which ODA is provided are encouraged to refrain from requiring exemptions from the taxes levied in recipient countries with respect to transactions relating to ODA projects, except to the extent that, and only as long as, the tax rules in the recipient country that would apply to these transactions are not consistent with the internationally-agreed tax principles described below or in exceptional cases where serious concerns with the payment of tax to that country result from a review of the governance structure, tax system or tax administration of that country.

2. In order to reduce situations in which specific tax exemptions with respect to ODA projects might be requested, recipient countries are encouraged to ensure that their tax treatment of transactions relating to ODA projects is consistent with the internationally-agreed tax principles described below.

Negotiation of tax provisions related to ODA projects

3. Recipient countries as well as donor countries, their aid agencies as well as international governmental organizations through which ODA is provided are encouraged to ensure that the tax authorities of the recipient country are involved in the negotiation and drafting of any provisions dealing with the tax treatment of transactions related to ODA projects, including where another ministry or government agency is taking the lead in the negotiation of any agreement, letter, memorandum of understanding or other document that will include such provisions.

Scope of negotiated ODA tax provisions

4. Where donors and recipient countries consider the adoption of specific provisions dealing with the tax treatment of transactions related to ODA projects, it is recommended that such provisions deal exclusively with the tax treatment of the donor countries and their aid agencies (and of their employees) as well as international governmental organizations through which ODA is provided and do not extend to other parties such as subcontractors and consultants. In particular, it is recommended that any specific exemption from income or corporate tax granted with respect to activities of enterprises that carry on activities in connection with an ODA project:

   a) is not available to enterprises of the recipient country, and

   b) is designed in a way that does not result in an unintended exemption of a foreign enterprise in its state of residence.

Transparency

5. Both recipient countries and donor countries, their aid agencies as well as international governmental organizations through which ODA is provided are encouraged to develop, review periodically and make publicly available their policies concerning the payment of taxes related to their ODA projects.

6. Subject to any applicable legal requirements concerning the confidentiality of taxpayer-specific information, recipient countries and donor countries, their aid agencies as well as international governmental organizations through which ODA is provided, should ensure that the parts of any treaty, agreement, letter, memorandum of understanding or other document to which they are parties that include provisions intended to govern the taxation, by a recipient country, of goods or services provided in the context of such assistance, are made publicly available.

Implementation of negotiated ODA tax provisions

7. Recipient countries are encouraged to ensure that all legal requirements necessary to give force of law to any agreement, letter, memorandum of understanding, or other document dealing with the tax treatment of transactions related to ODA projects that they enter into are satisfied.

8. Where tax exemptions for transactions related to ODA projects are granted, recipient countries should make every effort to forecast the revenue impact of these exemptions and to prepare, and make publicly available, regular tax expenditure reviews of them.

9. Where tax exemptions for transactions related to ODA projects are granted, countries are encouraged to use mechanisms that minimize administrative burdens and the risk of abuse.

10. For instance, where it is considered that tax relief from indirect taxes, including customs duties, must be granted with respect to goods or services used or supplied in relation to an ODA project of a country, aid agency or international governmental organization in cases other than those described in the above Guidelines, countries are encouraged to ensure that the taxes covered by the relief are clearly identified, using where possible the tax terminology of the recipient country, and the relief is

    a) restricted to clearly identified goods and services that are strictly necessary for the purposes of the project, and

    b) in the case of goods and services to be acquired specifically for that project, restricted to goods and services that are not available in the recipient country.

11. Also, where such relief from indirect taxes, including custom duties, is granted with respect to goods and services used in relation to an ODA project, recipient countries are encouraged to implement that relief through a refund method or, if not possible, through a system that reduces the risks of abuse and allows the monitoring of the costs associated to that relief. For instance, in the case of imported goods, the relief could be granted through an automated customs management system rather than through a direct exemption processed manually. The tax administrations of recipient countries are encouraged to adopt procedures to ensure that indirect tax is only relieved to the extent that the relevant goods and services are used for the purpose of the relevant project. For

example, they could clarify how an entity that manages an ODA project or part of such a project should report to the tax administration any situations where goods or services that have previously benefited from relief of value-added taxes under an exemption granted for that project are subsequently used for purposes not related to the project.

12. Any agreement concerning such relief from indirect taxes, including custom duties, with respect to goods used in relation to an ODA project should stipulate that when the relevant goods are disposed of in the recipient country or otherwise diverted from their intended purpose, the general domestic rules on disposal or diversion apply equally to these goods, in particular with respect to procedural aspects and the imposition of duties, taxes, interest and penalties in case of disposal or diversion.

13. Regardless of whether or not tax exemptions for transactions related to ODA projects are granted, donor countries, their aid agencies as well as international governmental organizations through which ODA is provided are encouraged to observe the information and withholding tax requirements of recipient countries with respect to payments made in relation to these projects.

RELEVANT INTERNATIONALLY-RECOGNIZED TAX PRINCIPLES

The following are internationally-recognized tax principles on which tax rules that are relevant to the tax treatment of transactions related to the provision of goods and services in the context of an ODA project are typically based.

As indicated in Guideline 1, a donor may be justified to request tax exemptions for ODA projects to the extent that the tax rules in the recipient country are not consistent with these principles. Where, however, a donor country and a recipient country are both parties to a multilateral or bilateral instrument (such as tax treaty) that provides rules that address relevant aspects of the tax treatment of the provision of goods and services in the context of an ODA project but that differ from the internationally-recognized tax principles described below, a donor would not be justified to consider that such rules are not consistent with internationally-agreed principles. Indeed, in such a case both countries have already reached an agreement as to tax rules that they both consider acceptable and a donor should not, therefore, consider that these rules result in unreasonable taxation.

Income taxation – employment remuneration

A. The remuneration, including employment-related benefits, for employment services related to an ODA project that an individual derives from that individual's employment by the government of the country or agency thereof that finances that project is typically not taxable in the recipient country if the individual

   a) is not a national of that jurisdiction, and

   b) is not a resident of that jurisdiction or became a resident solely for the purposes of rendering these services.

B. The remuneration, including employment-related benefits, that an individual to whom principle A does not apply derives from employment services related to an ODA project of a country, aid agency or international governmental organization, is typically not taxable in the recipient country if all the following conditions are met:

   a) the individual is not a resident of the recipient country,

b) during the project, the individual is not present in the recipient country for a period or periods exceeding in the aggregate 183 days in any twelve-month period beginning or ending in the relevant tax year;

c) the remuneration is paid by, or on behalf of, an employer who is not a resident of the recipient country, and

d) that remuneration is not borne by what tax treaties based on the OECD or UN Models refer to as a "permanent establishment" or "fixed base" which the employer has in that country.

Income taxation – profits and payments to foreign enterprises

C. Payments that a country, aid agency or international governmental organization makes in connection with an ODA project to an enterprise that is not an enterprise of the recipient country, as well as profits derived by that enterprise from activities exercised in connection with that project, are typically not subject to any income or corporate tax in the recipient country unless such payments or profits are attributable to what tax treaties based on the OECD or UN Models refer to as a "permanent establishment" or "fixed base" or fall within the scope of the provisions of such treaties that are similar to those of these models and that allow taxation by the recipient country. .

Indirect taxation - humanitarian crises

D. It is generally considered that no indirect taxes, including custom duties, should be imposed on the import of goods to be used to respond to humanitarian crises such as natural disasters, famine, or health emergencies. This corresponds to the rules of

a) Chapter 5 (Relief Consignments) of the Specific Annex J to the *International Convention on the simplification and harmonization of Customs procedures*, as amended (commonly referred to as "the Revised Kyoto Convention"), and

b) Annex B.9 (Concerning goods imported for humanitarian purposes) to the *Convention on temporary admission* (commonly referred to as "the Istanbul Convention").

(Countries that are not parties to these instruments are encouraged to incorporate the above-mentioned rules in their domestic laws.)

E. It is generally considered that goods that are provided domestically to, or imported by, a foreign country, aid agency or international governmental organization for direct use in response to a humanitarian crisis, and services closely connected with such supplies, that would – if imported - qualify as "relief consignments" or "goods for humanitarian purposes" for import duty and tax exemption on temporary admission, should be relieved from domestic indirect taxes.

Indirect taxation – personal property and household goods of workers

F. It is generally considered that personal property and household goods of workers coming to a recipient country for the purpose of an ODA project should be exempt from indirect taxes, including customs duties, as long as

a) these workers' stay is merely temporary and is related to that project, and

b) such property and goods are imported in the country solely for the personal use of the workers.

Indirect taxation – temporary admission

G. It is generally considered that no indirect taxes, including customs duties, should be imposed on the temporary admission of goods to be used for the purposes of an ODA project. This corresponds to the rules of:

a) Chapter 1 (Temporary Admission) of the Specific Annex G to the Revised Kyoto Convention"), and

b) the parts of the *Convention on temporary admission* (commonly referred to as "the Istanbul Convention") that relate to temporary admission of certain goods.

(Countries that are not parties to these instruments are encouraged to incorporate the above-mentioned rules in their domestic laws.)

EXPLANATIONS ON THE GUIDELINES

Basic principles concerning requests for tax exemptions for ODA projects

Guideline 1

1. Donor countries, their aid agencies as well as international governmental organizations through which ODA is provided are encouraged to refrain from requiring exemptions from the taxes levied in recipient countries with respect to transactions relating to ODA projects, except to the extent that, and only as long as, the tax rules in the recipient country that would apply to these transactions are not consistent with the internationally-agreed tax principles described below or in exceptional cases where serious concerns with the payment of tax to that country result from a review of the governance structure, tax system or tax administration of that country.

16. Until recently, donors were traditionally reluctant to agree to the recipient country's imposition of taxes in connection with their ODA projects. This might be because they consider that the effectiveness of the funds that they allocate to ODA will be greater if no part of these funds is required to be used to comply with otherwise applicable tax laws of the recipient country. It might also be, in some cases, that donors may actively oppose any portion of their ODA funds effectively being controlled by the recipient country government as they do not support certain expenditures financed by the regular budget. For example, the donor may be responding to a humanitarian crisis and providing support directly to refugees, but may wish to provide no support to the government. Such an unwillingness to permit ODA funds to ultimately be available to the recipient country government may arise from any number of foreign policy reasons or might relate, for example, to a judgment by the donor that the recipient's public expenditure management framework is so flawed (e.g. involving substantial corruption) that the proportion of ODA funding that would be paid as taxes runs the risk of being largely wasted or diverted. Another possible reason for a reluctance to finance taxes in the recipient country is a concern that the recipient's tax policy is unreasonable in some way, e.g. as regards rates of taxation which may be unusually high, as regards the determination of

the tax base which could be different from usual standards applicable to such taxes or as regards some discriminatory feature of the tax.

17. Another possible reason for a reluctance to finance taxes in the recipient country is a concern that the recipient's tax policy is unreasonable in some way, e.g. as regards rates of taxation, which may be unusually high; as regards the determination of the tax base, which could be different from usual standards applicable to such taxes; or as regards some discriminatory feature of the tax. Yet another reason could be that a donor might consider that because its budget for financing foreign aid is limited, the use of part of that budget to pay taxes to a developing country in relation to a development project in that country is in effect a zero-sum game for the developing country since the amount paid in taxes will simply decrease the amount available for funding the other costs of the project.

18. These reasons, however, must be reviewed in light of global efforts to strengthen domestic resource mobilization and, in particular, of the commitment, included in the Addis Ababa Action Agenda, to "consider not requesting tax exemptions on goods and services delivered as government-to-government aid".[12]

19. Concerns that a donor may have about public expenditure management in the recipient country may be warranted in some countries. However, a number of recipient countries have made substantial progress in this area. This suggests that, to the extent that the main concern of a donor is weak public expenditure management (e.g. a donor may feel that any ODA funds used to pay taxes would be vulnerable to corruption and mismanagement), this concern can be addressed on a case-by-case basis by reviewing the situation in the particular countries to which the donor is providing ODA. A review of the public expenditure management framework and an assessment of the performance of a tax administration of a recipient country could convince donors that this concern has been satisfied. Such a review could take advantage of the initiatives currently under way in a number of countries with the participation of the IMF, World Bank and other agencies.

20. Support for domestic resource mobilization efforts has become an increasingly important part of overall ODA over recent years, especially as it became clear that domestic resource mobilization was key to the financing of the 2030 SDG agenda. This increased willingness to provide support for increasing tax revenues points to a potential incoherence in simultaneously insisting on tax exemptions. It seems paradoxical for a donor to provide financial support for domestic resource mobilization while simultaneously insisting on tax exemptions.

21. The substantial changes that have been made to the tax systems of developing countries in recent years must also be taken into account. As a general matter, the level of tax rates has come down. Income tax rates in virtually all developing countries are much lower than they were, say, 30 years ago. Likewise, tariffs have been reduced or eliminated. As far as the assertion of tax jurisdiction is concerned, many developing countries have unilaterally retrenched their taxing jurisdiction to what would be typically be permitted under bilateral tax treaties. To the extent that a concern may remain about the tax system of a recipient country, the remedy might lie not in total exemption from tax of activities financed by ODA but a more limited exemption as would be called for under generally-recognized international tax principles.

12 See paragraph 1.

22. Moreover, the problems that the administration of tax exemptions for ODA projects create for recipient countries should be taken into account. These problems, some of which are described below, explain why the payment of taxes with respect to ODA projects is not a zero-sum game for developing countries even if one were to accept the argument that the amount paid in taxes would simply decrease the amount available for funding the other costs of the project.

23. First, given the limited capacity of tax and customs administrations in many countries that are recipients of ODA, the risks of abuse and fraud are always a concern where tax exemptions are made available. In the case of direct taxes, a typical risk is that a particular contractor or subcontractor might not report, and pay tax on, its income from a project that benefits from an exemption even if that exemption does not apply to the income tax payable by that contractor or subcontractor. In the case of indirect taxes, goods that have entered the country on an exempt basis can find their way into domestic commerce. Depending on the potential for abuse when goods pass through customs, all kinds of goods might be allowed to enter without paying VAT or customs duty, even though these goods should not actually qualify for exemption. The volume of goods involved might be several times the amount of the actual assistance. Depending on how the exemption is administered, abuse may well also arise from exempting local purchases from VAT. If the contractor is allowed to make purchases VAT-free upon presentation of an exemption card, the exemption is likely to be abused. Given the significant size of ODA, especially in least developed countries, this potential for abuse, can have a significant adverse effect on the domestic tax system and on the country's ability to provide essential services to its citizens.

24. The risk of abuse and the administrative burden can vary depending on the way that exemptions are structured. Reducing the risk of abuse and the administrative burden for recipient countries is one of the factors that have motivated some donors to review their policy concerning tax exemptions.

25. Second, tax exemptions impose administrative costs on the tax administrations of recipient countries which need to keep track of the various exemptions provided and implement them. This difficulty is amplified by the diversity of the practices and expectations of the multiple donors that recipient countries may need to deal with.

26. Third, the granting of tax exemptions can raise legal issues. In some countries, there is no proper legal basis for exemptions, i.e. they might be based on agreements that do not have the force of law. Even where a duly ratified treaty or law establishes exemptions, there are often difficulties of interpretation arising from vague drafting and inconsistencies between different relevant laws of the recipient countries, particularly where the exemptions are provided in laws separate from, and not properly integrated with, the tax laws. These difficulties are compounded where the Ministry of Finance and the tax authorities are not consulted prior to the granting of the tax exemptions and have not been involved in the drafting of the relevant legal provisions. Also, where issues of interpretation arise, it is often not clear how disputes should be resolved, i.e. whether courts of the recipient country should be the final arbiters of such disputes.

27. Fourth, tax exemptions can cause economic distortions detrimental to domestic production in recipient countries. If, for example, imported goods to be used for an ODA project are exempt, but no exemption is available for domestic purchases, then there will be a distortion in favor of importations.

28. Fifth, depending on how they are structured, tax exemptions can result in substantial transaction costs. Because policies on seeking tax exemptions may differ from donor to donor, officials in recipient countries need to familiarise themselves with various requirements, which can be confusing and complex particularly if the tax administration has limited capacity. Since these policies are superimposed on an existing legal framework, new legal issues may be presented (for example, whether a particular charge constitutes a "tax" which is eligible for exemption, or is instead a fee or user charge which is not eligible for exemption). There will also be substantial costs in terms of administrative overhead (legal, monitoring and budgetary) on the part of the donor (the donor's budget rules may prohibit financing of taxes, which will require checking reimbursable expenses to see whether they include taxes; agreements need to be drafted and contracts reviewed). Where problems arise, human resources have to be devoted to deal with them. In other words, the requirement to operate a special regime, as compared with the generally applicable tax regime, makes the contracts in question more expensive to administer.

29. Finally, granting tax exemptions to any market participants always runs the risk of creating pressures for further exemptions, whether directly as a means of alleviating competitive distortions that the initial exemption created or indirectly by creating a precedent that others can call on. Many recipient countries already find it hard to resist the pressure to grant specific tax exemptions when prospective private sector investors ask for such exemptions as an encouragement to invest on their territory. In addition, some recipient countries have complained that even where a donor agrees to finance the payment of tax with respect to a specific ODA project, contractors and subcontractors who are bidding to execute the project are requesting tax exemptions simply because they have obtained exemptions for similar projects and wrongly assume that being exempt from tax with respect to income derived from ODA projects is the norm. Many donors have actually urged developing countries to cut back on exemptions in their wider tax systems in order to strengthen domestic resource mobilization. This does not sit comfortably with continuing to press for exemptions for ODA projects.

30. These difficulties combined with the improvement of tax systems in developing countries and a greater recognition of the need for strengthening domestic resource mobilisation have led to a growing acceptance of the principle that the general rules of taxation should apply to ODA projects.

31. Guideline 1 endorses that approach. It encourages donors to refrain from requiring exemptions from the taxes levied in recipient countries with respect to transactions relating to ODA projects but it also recognizes that in some cases, there may be valid reasons for insisting on tax exemptions despite the various developments and considerations described above. This would be the case to the extent that the tax rules of the recipient country are not consistent with the internationally recognized tax principles referred to in the Guidelines. Also, in exceptional cases, exemptions might be justified to address serious concerns with the payment of tax to a country resulting from a review of the governance structure, tax system or tax administration of that country. One example would be where the governance structure of the recipient country is such that there is a serious risk that taxes paid with respect to the ODA project would be diverted to uses that the donor would clearly disapprove. Another example would be where the tax system of the recipient country seeks to levy taxes that are discriminatory or are clearly excessive (as regards their rate or structure) compared to what similar countries would levy in similar circumstances. A third example would be where corruption in the tax administration of

the recipient country would be so endemic that it would likely result in a large part of the taxes paid not being available to finance the budgetary expenditures of that country.

32. Where such considerations justify a request for tax exemptions, donors are encouraged to adopt a targeted approach and, where possible, restrict the exemptions to situations where these considerations are relevant. Guideline 1 therefore provides that where a request for exemptions appears to be justified, such exemptions should apply "to the extent that, and only as long as" the tax rules in the recipient country justify them. A tax exemption should only relieve the tax that is considered to be inappropriate. It needs to be tailored to minimize the difficulties for the recipient country.

33. It is also recognized that circumstances may change to the point where a donor country's initial assessment of the governance structure, tax system or tax administration of a recipient country may no longer justify paying taxes to that country. Also, serious deficiencies in the governance structure, tax system or tax administration of a recipient country may only appear during the implementation of a project. In these cases, the donor may require tax exemptions as a condition for continuing its assistance project. It may also suspend disbursements, or even the implementation of the project, until these deficiencies are addressed. On the other hand, provisions for tax exemptions related to the ODA projects are sometimes included in framework agreements that remain in place for a number of years and apply to different projects, despite the fact that the tax system of a recipient country may have improved to the point where tax exemptions are no longer justified. For these reasons, a donor's assessment of the governance structure, tax system or tax administration of a recipient country should be periodically reviewed.

34. In the case of donors that operate in many countries, it would be cumbersome to look at the details of the governance structure and the tax regime in each country. It would, however, be a duplication of effort for each donor to carry out such a review on its own. Also, where different donors are involved in the same assistance project, applying a different tax treatment to their respective contributions raises equity and administrative issues. This raises the question as to whether internationally agreed standards could be applied to the tax treatment of all ODA. Unfortunately, it would be quite difficult to agree internationally on such standards and cumbersome to establish procedures for their application to each recipient country. Necessarily, judgment is involved and accordingly the best approach may simply be to leave this determination to each donor concerned. Duplication of effort can, however, be minimized if both donors and recipients share information. If the decisions reached are shared among donors, together with any responses that the authorities wished to make in the case of taxes considered unreasonable, then all could benefit from the analysis carried out. The intention would not be to pass a judgement on the wider quality of a country's tax system but simply to make it easier for donors to conclude that taxes in a particular country are (or are not) broadly in line with normal international practice, and hence create some presumption that they should be allowed to apply to ODA projects. In practice, therefore — and as is to some degree already the case in relation to public expenditure management systems — donors could rely on reviews carried out by others, to the extent that those reviews are supported by credible documentation and analysis. The public disclosure of the tax-related provisions of agreements concluded between donors and recipient countries, as suggested in Guideline 6, will contribute to this sharing of information.

35. If, despite the above considerations, the donor insists on tax exemptions for its project, the recipient country may have little choice than to accept the granting of tax exemptions. In

such a case, however, it will still be important to take account of the procedural and administrative concerns reflected in these Guidelines.

Guideline 2

> *2. In order to reduce situations in which specific tax exemptions with respect to ODA projects might be requested, recipient countries are encouraged to ensure that their tax treatment of transactions relating to ODA projects is consistent with the internationally-agreed tax principles described below*.

36. In order to avoid situations where a donor might request tax exemptions for ODA projects in order to address cases where it considers that the recipient country's tax rules are inconsistent with internationally-agreed tax principles, recipient countries are encouraged to ensure that their tax treatment of transactions related to these projects is consistent with principles that are typically incorporated in widely-agreed international instruments. A list of such principles appears above and explanations on these principles are provided below.

Negotiation of tax provisions related to ODA projects

Guideline 3

> *3. Recipient countries as well as donor countries, their aid agencies as well as international governmental organizations through which ODA is provided are encouraged to ensure that the tax authorities of the recipient country are involved in the negotiation and drafting of any provisions dealing with the tax treatment of transactions related to ODA projects, including where another ministry or government agency is taking the lead in the negotiation of any agreement, letter, memorandum of understanding or other document that will include such provisions.*

37. Agreements covering ODA projects are often negotiated between representatives of the country, aid agency or international governmental organizations providing ODA and officials of the recipient country. Depending on the nature of the project, these officials might represent different ministries of the government of that country. There is no guarantee, however, that officials representing the tax authorities of that country will be consulted.

38. Given the technicality of tax legislation, the special procedural rules that might apply to the adoption of such legislation and the need to take account of administrative tax concerns, it is important that officials representing the tax authorities of a recipient country be involved in the negotiation and drafting of any specific tax provision dealing with ODA projects even if another ministry or government agency is taking the lead in the negotiations. Both the recipient countries and the donors should therefore insist that officials representing the tax authorities of the recipient country be involved in the negotiation and drafting of these provisions.

39. Whether these officials should come from the Ministry of Finance or the tax administration of the recipient country or from both is a matter that should be decided by that country taking into account the various responsibilities that have been granted to its tax administration. The officials that should be involved are those that would normally be responsible for designing tax rules applicable to foreign taxpayers. In many cases, these would

be officials of the Ministry of Finance. In some jurisdictions, however, the tax administration has the responsibility of designing and implementing tax legislation; in such a case, it would seem appropriate to have representatives from the tax administration involved in the negotiation and drafting of provisions dealing with the tax treatment of ODA projects. Regardless of which tax officials are involved, it will be important for officials from the Ministry of Finance and the tax administration of the recipient country to liaise and cooperate as regards both the negotiation and the implementation of these provisions. Also, since the tax exemptions might cover different types of taxes that may be administered by separate parts of the tax administration, it would be necessary for the recipient country to ensure that all relevant parts of its tax administration are consulted.

Scope of negotiated ODA exemptions

Guideline 4

> *4. Where donors and recipient countries consider the adoption of specific provisions dealing with the tax treatment of transactions related to ODA projects, it is recommended that such provisions deal exclusively with the tax treatment of the donor countries and their aid agencies (and of their employees) as well as international governmental organizations through which ODA is provided and do not extend to other parties such as subcontractors and consultants. In particular, it is recommended that any specific exemption from income or corporate tax granted with respect to activities of enterprises that carry on activities in connection with an ODA project:*
>
> *a) is not available to enterprises of the recipient country, and*
>
> *b) is designed in a way that does not result in an unintended exemption of a foreign enterprise in its state of residence.*

40. Guideline 4 recommends that the provisions granting tax exemptions to donor countries, their aid agencies as well as international governmental organizations through which ODA is provided should be restricted to these parties and should not extend to other parties, such as contractors and subcontractors. Unless such an extension is expressly agreed to, donor countries, their aid agencies as well as international governmental organizations through which ODA is provided are encouraged to make it clear that the private parties involved in the implementation of ODA projects are not entitled to the same exemptions. They should not encourage these private parties to try to obtain such exemptions from the recipient countries.

41. If, despite this recommendation, a country, aid agency or international governmental organization insists on a tax exemption for enterprises that will carry on activities in connection with an ODA project, Guideline 4 recommends that such exemption, at a minimum, should not apply to local enterprises and sub-contractors so that only foreign enterprises that are paid directly by the donor country, organization or agency are entitled to claim that exemption. This recognizes that the recipient country should have the final say in deciding whether or not local enterprises should be taxed; it also avoids the difficult issues involved in trying to determine which enterprises should be entitled to a general exemption granted with respect to an ODA project.

42. In addition, the exemption should be designed in a way that avoids unintended exemption in the country of residence of a foreign enterprise. The tax legislation of many

countries, and a number of tax treaties, exempt from tax profits of local enterprises that are attributable to permanent establishments located in other countries on the assumption that such profits will be taxable in these other countries. The combination of these provisions with a tax exemption granted in a bilateral agreement with respect to activities related to ODA projects could result in non-taxation without the tax authorities of both countries being aware of that situation. The involvement of tax authorities in the negotiation of tax provisions applicable to ODA projects (as is recommended in Guideline 3) should reduce the risk of this happening. At the time of the negotiation of such provisions, the tax officials from the recipient country could look at the tax law of the donor country and any applicable tax treaty in order to identify such cases of non-taxation.

Transparency

Guideline 5

> *5. Both recipient countries and donor countries, their aid agencies as well as international governmental organizations through which ODA is provided are encouraged to develop, review periodically and make publicly available their policies concerning the payment of taxes related to their ODA projects.*

43. Few donor countries, aid agencies and international governmental organizations through which ODA is provided have published their policy concerning the payment of taxes related to the ODA projects that they fund. Guideline 5 encourages the development, periodic review and publication of a policy in that area. This would give the opportunity to a donor to periodically reflect on the various policy considerations presented in these Guidelines and to verify that the donor's practices as regards tax exemptions for ODA projects still reflect that donor's general approach to foreign aid. It would also encourage greater uniformity among donors and projects, especially since ODA agreements are often negotiated at the local level (e.g. by embassy staff), which can result in significant differences between agreements concluded by the same donor. Also, a vague undocumented policy of not agreeing to pay tax lacks clarity on scope and practical implementation (e.g. which taxes should be exempted, who should benefit from the exemptions, how should the exemptions be administered).

44. A published policy concerning the payment of taxes related to the ODA projects could cover a number of questions, such as:

- Which parts of the donor are involved in the development and periodic review of the policy;
- When and how has the policy changed and whether any such changes apply to existing projects or only to new projects;
- What is the overall policy of the donor concerning the payments of taxes with respect to transactions related to the ODA projects that the donor funds;
- Does the policy apply uniformly with respect to all recipient countries or makes a distinction between these countries (and, in that case, based on which factors);
- What is the rationale for that policy;
- If the policy is to request tax exemptions:

- for which taxes would these exemptions be requested,
- which taxpayers/entities would be covered by these exemptions (especially as regards local employees and contractors/sub-contractors),
- would there be any limits/exceptions to the exemptions,
- how are the exemptions intended to be claimed in practice.

45. Guideline 5 also encourages recipient countries to develop, review periodically and make publicly available their own policy concerning the granting of tax exemptions for ODA projects. The tax authorities should obviously be involved in the development of that policy, which would be particularly important in countries where the tax authorities are not systematically involved in the negotiation of the provisions under which such tax exemptions may be granted. At a minimum, the development of a recipient country's policy concerning the granting of tax exemptions for ODA projects could help that country reduce differences in the tax treatment of similar ODA projects.

Guideline 6

> *6. Subject to any applicable legal requirements concerning the confidentiality of taxpayer-specific information, recipient countries and donor countries, their aid agencies as well as international governmental organizations through which ODA is provided, should ensure that the parts of any treaty, agreement, letter, memorandum of understanding or other document to which they are parties that include provisions intended to govern the taxation, by a recipient country, of goods or services provided in the context of such assistance, are made publicly available.*

46. Provisions granting tax exemptions for ODA projects are often included in agreements that are not public and that may be negotiated without the involvement of the tax authorities. Sometimes, a tax administration does not even have access to the wording of these provisions even though it is responsible for their application.

47. The constitutional and legal principles applicable in a large number of countries, however, require the legislative adoption of, and full public access to, the rules concerning the exercise of a State's taxing powers while also ensuring the confidentiality of taxpayer-specific information. The transparency of the legal provisions granting tax exemptions is crucial. For this reason, Guideline 6 provides that, subject to any applicable legal requirements concerning the confidentiality of taxpayer-specific information, the parts of any agreement, letter, memorandum of understanding or other document that relate to the tax treatment of transactions related to ODA projects should be made publicly available. For example, the United States has long followed the practice of publishing the treaties and agreements through which it secures tax exemptions for the ODA that it provides, which facilitates the

identification of potential risks of tax avoidance.[13] A similar approach should be followed by recipient countries and donors.[14]

48. Publication of a recipient country's laws on its web site may contribute to making legal provisions granting tax exemptions to ODA projects publicly available. While the registration and publication of a country's treaties envisaged by Article 102 of the United Nations Charter could contribute to the public disclosure of the tax exemptions that are included in treaties, it should be noted that the Regulations adopted to give effect to Article 102[15] give the United Nations Secretariat the option not to publish *in extenso* treaties or international agreements belonging to certain categories, including those dealing with "[a]ssistance and cooperation agreements of limited scope concerning financial, commercial, administrative or technical matters".[16]

Implementation of negotiated ODA tax provisions

Guideline 7

> *7. Recipient countries are encouraged to ensure that all legal requirements necessary to give force of law to any agreement, letter, memorandum of understanding, or other document dealing with the tax treatment of transactions related to ODA projects that they enter into are satisfied.*

49. Tax exemptions for ODA projects may be provided through a variety of legal instruments and may require different administrative practices being applied to a substantial number of different transactions in the context of each country's general tax rules. Exemptions might be granted, for example, through specific exemptions in domestic law directed to international assistance, through bilateral agreements, letters or memoranda of understanding.

50. In many countries, however, the constitution or the law impose restrictions as to how tax provisions may be adopted. Frequently, there will be rules according to which any tax charge or tax exemption must be authorized by law in order to be enforceable. Such rules will often apply regardless of the instrument in which the tax exemption is granted (e.g. a bilateral treaty, memorandum of understanding or any form of bilateral agreement).

51. There have been cases where tax exemptions included in a bilateral agreement concluded between a donor and the government of a recipient country have been found not to be enforceable because such rules had not been complied with. It is therefore necessary to ensure that any agreements providing for tax exemptions with respect to an ODA project will be implemented in accordance with these rules. In cases where tax exemptions for transactions

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13 Id. at page 18, which includes an example of non-taxation resulting from a personal tax exemption granted with respect to ODA which was identified because of the publication of such an agreement by the United States.

14 ATAF suggests that the publication of the entire ODA project agreement, and not only the parts thereof dealing with taxation, could be done directly by donors or through a central repository such as the one through which the International Aid Transparency Initiative (IATI) already provides information on ODA projects. See *The Taxation of Foreign Aid – Don't ask, Don't tell, Don't know,* supra note 6, at page 2.

15 See https://treaties.un.org/pages/Resource.aspx?path=Publication/Regulation/Page1_en.xml.

16 Article 12, paragraph 2(a) of the Regulations.

related to ODA projects are contemplated, the parties are encouraged to use legal instruments that support the rule of law in recipient countries by:

- Making sure that the exemption is provided by law or, if provided under agreements, that the agreements are authorized by law;
- Identifying with specificity the transactions benefiting from exemption, the applicable taxes, and the conditions for benefiting from exemption.

52. Participation of the appropriate officials from the Ministry of Finance or tax administration in the negotiation of these exemptions, as recommended in Guideline 3, will often be the best way of ensuring that this is done.

53. Giving force of law to exemptions with respect to subnational taxes may require the involvement of subnational governments. It should not be assumed that generally-worded exemptions apply to subnational taxes.

Guideline 8

> *8. Where tax exemptions for transactions related to ODA projects are granted, recipient countries should make every effort to forecast the revenue impact of these exemptions and to prepare, and make publicly available, regular tax expenditure reviews of them.*

54. In order to provide the transparency and information needed for policy making and public discussion, recipient countries should seek to forecast the amount of tax revenues that will be lost as a result of these exemptions. They should also consider preparing and publishing tax expenditure analyses indicating the tax actually foregone as a consequence of exemptions granted with respect to foreign assistance.

55. Clearly, however, the extent to which a country will be able to correctly forecast and report on the foregone tax revenues resulting from tax exemption for ODA projects will depend on its administrative capacity and technical assistance may be needed for that purpose.

Guideline 9

> *9. Where tax exemptions for transactions related to ODA projects are granted, countries are encouraged to use mechanisms that minimize administrative burdens and the risk of abuse.*

56. Where it has been agreed to exempt from tax transactions related to ODA projects, it is important to do so in a way that minimize the burden, for the recipient country, of administering that exemption while, at the same time, minimizing the scope for tax fraud.

57. Guidelines 10 to 12 provide guidance as to how this may be done in the area of indirect taxes and customs duties. As regards reliefs related to direct taxes, requiring taxpayers to declare the income received that is subject to an exemption and to identify the provisions under which the exemption is claimed facilitates risk-management of tax audits as well as the calculation of the amount of foregone tax revenues attributable to this type of tax exemption.

Guideline 10

> *10. For instance, where it is considered that tax relief from indirect taxes, including customs duties, must be granted with respect to goods or services used or supplied in relation to an ODA project of a country, aid agency or international governmental organization in cases other than those described in the above Guidelines, countries are encouraged to ensure that the taxes covered by the relief are clearly identified, using where possible the tax terminology of the recipient country, and the relief is*
>
> *a) restricted to clearly identified goods and services that are strictly necessary for the purposes of the project, and*
>
> *b) in the case of goods and services to be acquired specifically for that project, restricted to goods and services that are not available in the recipient country.*

58. Guidelines 10 to 12 deal with the drafting and implementation of specific provisions for the relief from indirect taxes, including import duties, with respect to goods and services related to ODA projects. These Guidelines are relevant when it is decided that the recipient country should grant relief beyond the situations covered by the internationally-recognized tax principles dealing with indirect taxes that are described above.

59. Tax exemptions from indirect taxes and import duties that are currently found in bilateral agreements are often worded too broadly. Many of these agreements fail to clearly identify the type of goods that qualify for the exemption otherwise than by reference to general terms such as "equipment", "instruments", "machinery", or even broader terms such as "supplies", "assets" or "resources", albeit limited to what is "necessary" to carry out the project, or is "financed by" the donor. In some agreements, the latter reference is in fact the only limitation to the scope of the exemption.

60. If it is considered that a tax exemption from indirect taxes, including custom duties, must be granted with respect to goods used or supplied in the context of ODA projects, it is paramount that from the outset there be as little doubt as possible as to which goods qualify for exemption. Indeed, whereas initially both parties may have a clear idea of what qualifies for exemption, that understanding may often change over time. A clearly and unambiguously defined scope of application is also a prerequisite for efficient administration by the recipient country's authorities. The goods for which an exemption is made available should therefore be clearly identified by the agreement; preferably the agreement, or an annex thereto, should list the goods or categories of goods concerned, ideally by reference to their HS[17] classification code.

61. Especially for materials that can easily be diverted to the local market, such as raw materials (e.g., construction materials) and other commodities (e.g., fuel), the agreement, or an annex thereto, should determine maximum quantities; at the very least, the agreement should

17 "The Harmonized Commodity Description and Coding System generally referred to as 'Harmonized System' or simply 'HS' is a multipurpose international product nomenclature developed by the World Customs Organization (WCO)" (http://www.wcoomd.org/en/topics/nomenclature/overview/what-is-the-harmonized-system.aspx).

provide for a mechanism to determine such maximum levels in common accord and prior to the introduction of the goods into the recipient country.

62. Also, from a tax policy perspective, donors should not insist on, and recipient countries should not grant, tax exemptions for goods that are identical or essentially similar to those available on the local market of the recipient country.

63. Moreover, the terminology used to identify the taxes for which exemption is granted is often unclear and sometimes inconsistent. The terms range from just "customs duties" over "all customs duties and taxes" and "import duties, customs duties and other taxes" to "all taxes or charges", and sometimes specifically refer to "value added taxes". Some agreements even provide exemption from import restrictions or prohibitions, whether or not limited to what would be "otherwise required for reasons of public health or safety". Certain agreements include a reference to export taxes, restrictions or prohibitions. Agreements rarely define the terms used or contain a list of the taxes covered by the exemption. This wide variation also appears between agreements concluded by the same donor country and there may even be inconsistency within the same agreement.

64. This lack of precision may raise questions of interpretation. When the exemption is for "customs duties" only, it may be argued that other taxes due on importation (e.g., GST/VAT, excise tax/other consumption taxes) are not exempt, whereas under a clause referring to "import duties, customs duties and other taxes" they clearly are. In the latter case, however, the question may arise whether service charges such as harbor dues, warehouse or handling charges or fees and the like are also waived, whereas there may be less doubt under a clause referring to "all taxes and charges".

65. Such issues of interpretation are compounded by the inconsistencies between the various agreements a country may have entered into, whether as a donor country or as a recipient country. Minor variations between the various agreements require constant and careful attention, in particular by the competent authorities of the recipient country, who often lack sufficient administrative capacity to do so effectively and efficiently.

66. It is therefore important that taxes covered by the exemption be clearly identified, using the tax terminology of the recipient country. Ideally, a list of the recipient country's taxes and levies for which exemption is granted will be included in the agreement itself, or in an annex, with a general provision allowing the agreement to continue to apply if these taxes are modified or replaced by broadly similar taxes.

Guideline 11

> *11. Also, where such relief from indirect taxes, including custom duties, is granted with respect to goods and services used in relation to an ODA project, recipient countries are encouraged to implement that relief through a refund method or, if not possible, through a system that reduces the risks of abuse and allows the monitoring of the costs associated to that relief. For instance, in the case of imported goods, the relief could be granted through an automated customs management system rather than through a direct exemption processed manually. The tax administrations of recipient countries are encouraged to adopt procedures to ensure that indirect tax is only relieved to the extent that the relevant goods and services are used for the purpose of the relevant project. For example, they could clarify how an entity that manages an ODA project or*

part of such a project should report to the tax administration any situations where goods or services that have previously benefited from relief of value-added taxes under an exemption granted for that project are subsequently used for purposes not related to the project.

67. Countries use different procedures for granting import duty and indirect tax exemptions. Some countries grant immediate exemption while other countries require some or all exempt importers to pay import duties and taxes and file for reimbursement at a later date. Also, a number of francophone African countries have introduced a treasury voucher system to monitor exemptions, in particular for ODA projects. Existing instruments generally do not advocate a particular method for granting or controlling exemptions in general or in relation to ODA projects in particular.

68. From an administrative perspective, a system where the exemption is processed manually at the time it is requested should be discouraged. A reimbursement method and the use of an automated customs management system are generally to be preferred and Guideline 11 encourage recipient countries the use these methods.

69. A reimbursement system offers a number of advantages, including relieving the strain on the verification stage, which has the double advantage of speeding up the clearance process and making more customs personnel available for post-clearance controls (audits, physical checks) that are both more efficient and more trade-friendly. Experience shows that reimbursement systems can be successfully implemented, leading in some cases to an increase of government revenue.[18]

70. It has been suggested that, when implemented and administered properly, the voucher system used by some francophone African countries[19] could also be an effective method for eliminating or greatly reducing abuse and revenue loss from this type of exemption. Under this system, import duties and taxes in connection with qualifying projects are payable by way of treasury credit vouchers issued by the government. ODA public procurement bids must be submitted on a tax-inclusive basis, which thus requires the bidders to carefully plan and calculate their projects. When the contract is assigned, treasury vouchers are issued to the contractor up to the contractor's forecasted amount of duties and taxes.[20] Any excess tax burden falls on the contractor. The system thus has a built-in control mechanism: bidders will be careful not to overstate their tax forecast to obtain the contract, while an understatement leaves the contractor to bear the excess tax burden when the contractor wins the bid. In addition, it allows the government of the recipient country to keep track of foregone amounts of duties and taxes.

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18 E.g., Mali, cited in Customs Modernization Handbook, World Bank 2005, p. 238, box 10.9

19 See e.g. for Guinea: Instruction No 196/414/PM/MBRSP of 13 December 1996 on the tax treatment of government procurement: http://www.droit-afrique.com/images/textes/Guinee/Guinee%20-%20Regime%20fiscal%20marches%20publics.pdf

20 The system identifies which duties and taxes may be financed by the government through treasury vouchers, and which taxes must always be borne by the contractor. For instance, under the Guinea rules (see previous footnote) only (1) import duties and taxes on goods the ownership of which is transferred to the recipient country in the course of the project or which are incorporated into the constructions that are transferred to the recipient country, and (2) VAT on the domestic supplies under the contract are payable with "chèques sur le Trésor Série Spéciale" or "CTSS". For contracts which are only partly donor-financed, vouchers are issued only in proportion to the foreign aid provided.

71. Research on the use of the voucher system in Togo and Dahomey,[21] however, has suggested that since the value of vouchers was 1-2% of GDP, that system may risk distorting macroeconomic data (especially tax-to-GDP ratios). Also, while this system is straightforward for import duties and taxes and for single-stage domestic sales taxes, it is more complicated for "domestic VAT" (i.e. VAT on domestic supplies, other than import VAT). Indeed, the amount of domestic VAT for which exemption and thus treasury vouchers may be claimed is not necessarily equal to the amount of output VAT (i.e. the total consideration for the supply multiplied by the VAT rate) but is the net amount of VAT due (i.e. the output VAT minus the input VAT on domestically sourced supplies or taxed imports), the forecasting of which may prove to be more difficult.

72. Contractors under ODA projects for which duty and tax exemptions are available thus have an incentive to insist on outright VAT exemption for their domestically sourced supplies, which "break" the VAT chain and thus undermine the VAT system of input tax credits. Indeed, domestic suppliers further down the supply chain will also claim exemption, thus leading to "exemption creep" in the VAT system.[22] Another potential weakness of the voucher system may be the risk of forgery of vouchers.

73. Guideline 11 also recognizes that whatever system is used, the tax administration of the recipient country should ensure that proper administrative procedures are applied to ensure that goods and services on which indirect tax will be relieved are used for the purpose of the relevant project. Even if a list of exempted goods and their quantity is provided to the tax administration, the tax administration may find it problematic to monitor the quantity of such goods that are eligible for exemption. Fuel taxes (e.g. VAT and excise taxes on fuel) are particularly prone to abuse; while exemptions from such taxes are frequently requested, recipient countries should be particularly wary of granting such exemptions.

74. In the case of imported goods, such procedures would typically include

- Establishing a clear and strict authorization procedure to identify the importer, the type and quantity of the goods and the exempt use for which they will be imported; [23]
- Verification upon importation, to reconcile the goods, the import declaration and supporting documents presented to customs with the prior authorization; and
- Post-clearance controls to verify whether the imported goods are put to, and are not diverted from, their exempt use.

75. In the case of imported goods, the use of an automated customs management system, such as the ASYCUDA[24] developed by UNCTAD, will help administer any available exemptions while facilitating trade by reducing transaction time and costs.

Guideline 12

> *12. Any agreement concerning such relief from indirect taxes, including custom duties, with respect to goods used in relation to an ODA project should stipulate*

21 Caldeira *et al*, "Taxing aid: the end of a paradox?", note 10.

22 See L. Ebril, M. Keen, J.-P. Bodin and V. Summers, The Modern VAT, IMF 2001, p. 89.

23 For example, one country has had recourse to a team of engineers in order to determine the quantity of materials required for specific projects, which allowed it to limit the quantity for which an exemption could be claimed.

24 *Automated System for Customs Data* (ASYCUDA) (see https://asycuda.org/en/).

that when the relevant goods are disposed of in the recipient country or otherwise diverted from their intended purpose, the general domestic rules on disposal or diversion apply equally to these goods, in particular with respect to procedural aspects and the imposition of duties, taxes, interest and penalties in case of disposal or diversion.

76. Most agreements providing for relief from indirect taxes with respect to goods used or provided in the context of ODA projects do not stipulate what happens when these goods are subsequently disposed of or diverted from their intended purpose. In most cases, duties and taxes should become payable under general domestic rules related to disposal or diversion of goods on which tax was not previously paid. Guideline 12 addresses that issue and provides that the application of domestic rules applicable to such disposals and diversions should be clarified in order to avoid any uncertainty, in particular with respect to procedural aspects and the imposition of duties, taxes, interest and penalties.

Guideline 13

13. Regardless of whether or not tax exemptions for transactions related to ODA projects are granted, donor countries, their aid agencies as well as international governmental organizations through which ODA is provided are encouraged to observe the information and withholding tax requirements of recipient countries with respect to payments made in relation to these projects.

77. Under most tax systems, persons that make certain payments to resident or non-resident taxpayers are required to inform tax authorities about these payments and, in some cases, to withhold tax on these payments. This is typically the case for the payment of remuneration to employees and subcontractors. Regardless of whether tax exemptions for transactions related to ODA projects are granted or whether they are themselves exempt from tax for other reasons, donor countries, their aid agencies as well as international governmental organizations through which ODA is provided should assist the tax authorities of recipient countries by complying with the applicable information and withholding tax requirements with respect to payments that they make to taxable entities in relation to these ODA projects.

EXPLANATIONS ON THE INTERNATIONALLY-RECOGNIZED TAX PRINCIPLES APPLICABLE TO ODA PROJECTS

78. The following paragraphs provide additional explanations on the internationally-recognized tax principles listed above and on which tax rules that are relevant to the tax treatment of transactions related to the provision of goods and services in the context of an ODA project are typically based.

Income taxation – employment remuneration

Principle A

A. The remuneration, including employment-related benefits, for employment services related to an ODA project that an individual derives from that individual's employment by the government of the country or agency thereof that finances that project is typically not taxable in the recipient country if the individual

a) is not a national of that jurisdiction, and

b) is not a resident of that jurisdiction or became a resident solely for the purposes of rendering these services.

79. Principle A is based on the provisions of paragraph 1 of Article 19 of the United Nations Model Double Taxation Convention between Developed and Developing Countries (the UN Model)[25] and the OECD Model Tax Convention on Income and on Capital[26] (OECD Model). These provisions are found in almost all bilateral tax treaties currently in force. As noted in the Commentary on these models "[s]imilar provisions in old bilateral conventions were framed in order to conform with the rules of international courtesy and mutual respect between sovereign States".[27] The principle that a state should not levy income tax on the remuneration of employees of another state who perform governmental services on the territory of the former state is now universally accepted. It must be stressed, however, that this principle applies only to employees of a state and does not extend to other parties, such as subcontractors, who provide services to a state.

80. Nothing in Principle A or in rules based on that principle affects the exemptions to which various members of diplomatic missions or consular posts are entitled under the general rules of international law or under multilateral instruments such as the *Vienna Convention on Diplomatic Relations* and the *Vienna Convention on Consular Relations*. These exemptions are applicable regardless of whether or not specific exemptions are granted with respect to government employees providing services in the context of a particular ODA project.

81. Principle A includes the exception, which is found in paragraph 1 of Article 19 of the UN Model and OECD Model and in the two Vienna Conventions mentioned in the previous paragraph, that recognizes that a recipient country may tax the remuneration paid to local personnel who are permanent residents or nationals of that country. That exception is intended to ensure that locally-recruited personnel (e.g. translators or security guards hired for the duration of an ODA project) are not entitled to the same treatment as employees of a state sent to a foreign country.

82. Principle A does not address the treatment of employees of international organizations as there is less international consensus on this issue. In any event, the tax treatment of employees of international organizations in the states that are members of that organization is often regulated by the agreements under which these organizations are established.

Principle B

B. The remuneration, including employment-related benefits, that an individual to whom Principle A does not apply derives from employment services related to an ODA project of a country, aid agency or international governmental

25 United Nations, Department of Economic and Social Affairs, United Nations Model Double Taxation Convention between Developed and Developing Countries 2017, (New York: United Nations, 2018), available at http://www.un.org/esa/ffd/wp-content/uploads/2018/05/MDT_2017.pdf.

26 OECD (2017), Model Tax Convention on Income and on Capital: Condensed Version 2017, OECD Publishing, Paris, https://doi.org/10.1787/mtc_cond-2017-en, available at https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-condensed-version-2017_mtc_cond-2017-en#page1.

27 Paragraph 2 of the Commentary on the UN Model Tax Convention, quoting paragraph 1 of the Commentary on the OECD Model Tax Convention.

organization, is typically not taxable in the recipient country if all the following conditions are met:

a) the individual is not a resident of the recipient country,

b) during the project, the individual is not present in the recipient country for a period or periods exceeding in the aggregate 183 days in any twelve-month period beginning or ending in the relevant tax year;

c) the remuneration is paid by, or on behalf of, an employer who is not a resident of the recipient country, and

d) that remuneration is not borne by what tax treaties based on the OECD or UN Models refer to as a "permanent establishment" or "fixed base" which the employer has in that country.

83. Principle B is based on a rule found in almost all bilateral tax treaties and incorporated in paragraph 2 of Article 15 of the UN Model and the OECD Model. Under that rule, where a person employed by a foreign enterprise exercises his/her employment in a recipient country for a short period of time, the relevant employment income is exempt from income taxation in the recipient country.

84. This exemption would typically apply to employees of foreign commercial enterprises who are performing work in the recipient country pursuant to contracts concluded with the donor. Since these individuals would not be employed directly by that donor, they would not be entitled to the exemption referred to in Principle A and should be subject to the normal taxation rules of the recipient country, subject to this exemption for short-term employment activities.

85. Since the wording of Principle B is derived from that used in tax treaties, it should be read in the same way. The references to "resident", "permanent establishment" and "fixed base" should therefore be given the meaning that it generally has for the purposes of tax treaties and the 183-day rule should be interpreted in accordance with the guidance found in the Commentary on the UN Model and OECD Model.

Income taxation – profits and payments to foreign enterprises

Principle C

C. Payments that a country, aid agency or international governmental organization makes in connection with an ODA project to an enterprise that is not an enterprise of the recipient country, as well as profits derived by that enterprise from activities exercised in connection with that project, are typically not subject to any income or corporate tax in the recipient country unless such payments or profits are attributable to what tax treaties based on the OECD or UN Models refer to as a "permanent establishment" or "fixed base" or fall within the scope of the provisions of such treaties that are similar to those of these models and that allow taxation by the recipient country.

86. Principle C is intended to reflect the circumstances in which, under the existing international principles incorporated in bilateral tax treaties, a country is typically prevented from taxing the profits of foreign enterprises.

87. Indeed, most bilateral tax treaties, and the UN and OECD models on which they are based, provide that, as a general rule subject to certain exceptions, foreign enterprises that are paid from abroad to carry on activities in a country (which would include, for example, a non-resident self-employed subcontractor) should only be taxable in that country on profits attributable to these activities when these are carried on in that country through what these treaties based on the OECD and UN models refer to as a "permanent establishment" or "fixed base". Such enterprises may also be taxed on income that fall within the scope of the more limited provisions of these treaties that are similar to those of these models and that allow taxation by the recipient country in other circumstances. These more limited provisions would cover, for example, the income for work performed in a recipient country by a self-employed engineer who does not have a permanent establishment or fixed base in that country but who would spend more than 183 days in that country throughout a 12-month period, a situation that would fall within the provisions of treaties that are similar to those of Article 14 of the UN model.

88. Principle C refers to enterprises that are not residents of the recipient country. The term "enterprise" applies to all forms of business organizations and would therefore apply to a large company as well as to an individual consultant providing services as a sole proprietorship, as shown by the examples in paragraph 87. This would cover, among other things, situations where an individual who is not a resident of the recipient country performs work in that country in a non-employment relationship as part of an ODA project.

89. As already explained in paragraph 85 above in relation to Principle B, since the wording of Principle C is derived from that used in tax treaties, it should be read in the same way, in particular as regards the references to "resident", which should be given the meaning that it generally has for the purposes of tax treaties. This is also the case for other principles that refer to treaty concepts.

Indirect taxation - humanitarian crises

Principle D

> *D. It is generally considered that no indirect taxes, including custom duties, should be imposed on the import of goods to be used to respond to humanitarian crises such as natural disasters, famine, or health emergencies. This corresponds to the rules of*
>
> *a) Chapter 5 (Relief Consignments) of the Specific Annex J to the International Convention on the simplification and harmonization of Customs procedures, as amended (commonly referred to as "the Revised Kyoto Convention"), and*
>
> *b) Annex B.9 (Concerning goods imported for humanitarian purposes) to the Convention on temporary admission (commonly referred to as "the Istanbul Convention").*
>
> *(Countries that are not parties to these instruments are encouraged to incorporate the above-mentioned rules in their domestic laws)*

90. Supplies by donor countries, international governmental organizations and agencies thereof to respond to acute humanitarian crises constitute a subcategory of ODA projects that has the following characteristics:

- to be effective, such consignments must be delivered rapidly to their ultimate recipients, i.e. those affected by the crises, and
- the case for relieving such supplies from taxes and duties is particularly strong, as there is little economic sense in taxing such supplies (the recipients do not have ability-to-pay), and the revenue risks involved in exempting such supplies are equally small.

91. The existence of transparent and harmonized rules regarding the tax treatment of emergency aid that would already be in place before a crisis occurred is paramount for swift and efficient donor intervention.

92. Many countries have adopted domestic tax provisions regarding "relief consignments", but there is substantial variation in their scope of application, both with respect to the type of taxes and with respect to the type of supplies. Few countries appear to have specific provisions on temporary admission for relief consignments, although there is usually a general regime for temporary admission in the customs laws.

93. In addition to these domestic law provisions, a number of countries have entered into bilateral assistance agreements with other countries, international organizations, their agencies or other donors. While these agreements may cover many of the issues discussed below, they may not systematically address all of them. Moreover, these agreements often show differences, minor or major, between them both regarding the duties and taxes as well as the nature of activities covered. Furthermore, by their nature, such agreements only cover activities by the contracting donor country, organization or agency, and their facilities are thus not available to others. Finally, such agreements are usually not published or publicly disseminated, or at least not systematically or in the same way as ordinary tax laws and regulations, thus lacking transparency and adding to the complexity of applying them. In many countries, tax and customs officials may not have ready access to them or be familiar with their terms.

94. A number of international instruments currently exist in this area. These mainly concern clearance procedures and relief from import and export duties and taxes, but do not cover taxes on domestic transactions. Also, these instruments have not been universally adopted. The main international instruments in this area are managed by the World Customs Organization (WCO).[28] They are:

- Chapter 5 on Relief Consignments of the Specific Annex J to the Revised Kyoto Convention.[29] The Guidelines to which also comprise the Recommendation of the Customs Co-operation Council to expedite the forwarding of relief consignments in the event of disasters, and the UN Model Agreement on Customs Facilitation in International Emergency Humanitarian Assistance; and

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28 The WCO is the working name adopted by the Customs Co-operation Council, an intergovernmental organization established in 1952 to enhance the effectiveness and efficiency of customs administrations; see http://www.wcoomd.org/.

29 *International Convention on the simplification and harmonization of Customs procedures* (as amended), done at Kyoto on 18 May 1973, commonly referred to as "the Revised Kyoto Convention". The Revised Kyoto Convention is comprised of the Body of the Convention, of a General Annex, and of ten Specific Annexes, most of which are further divided into two or more Chapters. Countries may accede to the Convention without accepting any or all of the Specific Annexes and/or Chapters (Article 8(3) of the Convention). See http://www.wcoomd.org/Topics/Facilitation/Instrument%20and%20Tools/Conventions/pf_revised_kyoto_conv/Instruments for the list of signatories

– Annex 9.B. (Goods imported for humanitarian purposes) to the Istanbul Convention.[30]

95. Principle D refers to the rules of these existing international instruments. By incorporating these rules in their domestic law (either by becoming parties to the relevant instruments or by unilaterally adopting these rules by law), countries would overcome the need to enter into bilateral agreements to deal with humanitarian crises.

96. Countries may want to take account of the following guidance when designing rules and administrative practices for exempting relief consignments from import duties and taxes:[31]

– A definition of "relief consignments" should be included along the following lines:

> *goods, including vehicles and other means of transport, foodstuffs, medicaments, clothing, blankets, tents, prefabricated houses, water purifying and water storage items, or other goods of prime necessity, forwarded as aid to those affected by disaster; and*
>
> *all equipment, vehicles and other means of transport, specially trained animals, provisions, supplies, personal effects and other goods for disaster relief personnel in order to perform their duties and to support them in living and working in the territory of the disaster throughout the duration of their mission.*[32]

– Countries may find it useful to refer to the following definition of "disaster" in Article 1 of the *UN Model Agreement on Customs Facilitation in International Emergency Humanitarian Assistance*:

> *A serious disruption of the functioning of the society, causing widespread human, material, or environmental losses which exceed the ability of affected society to cope using only its own resources.*
>
> *The term covers all disasters irrespective of their cause (i.e. both natural and manmade).*

– Accelerated and simplified clearance procedures for relief consignments should be provided[33] so that customs clearance of relief consignments is carried out as a matter of priority and simplified and expedited clearance procedures can be used, such as the lodging of a simplified, provisional or incomplete declaration, pre-arrival declarations, clearance outside normal hours and without normal charges as well as examination/sampling in exceptional circumstances only. Such clearance procedures should be provided for in the customs legislation and the necessary procedures should be planned for in advance and documented so that they can be implemented in short order.

– The exemption from duties, taxes and restrictions applicable provided for relief consignments should include[34] a waiver from economic export prohibitions or

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30 *Convention on Temporary Admission*, done at Istanbul on 26 June 1990, commonly referred to as "the Istanbul Convention". Similar to the Revised Kyoto Convention, the Istanbul Convention comprises a body and different Annexes. Countries may accede to the Convention without accepting all Annexes, although they have to accept at least Annex A on Temporary Admission Papers and one other Annex (Article 24(4) of the Convention). See http://www.wcoomd.org/Topics/Facilitation/Instrument%20and%20Tools/Conventions/pf_revised_kyoto_conv/Instruments for the list of signatories.

31 See Chapter 5 on Relief Consignments of the Specific Annex J to the Revised Kyoto Convention.

32 Ibid.

33 See Standards 2 and 3 of Chapter 5 of the Specific Annex J to the Revised Kyoto Convention.

34 Recommended Practices 5 and 6 of Chapter 5, Specific Annex J to the Revised Kyoto Convention.

restrictions, and export duties and taxes otherwise payable; as well as a waiver from import prohibitions and restrictions, and import duties and taxes, for relief consignments received as gifts by approved organizations for use by or under the control of such organizations, or for distribution free of charge by them or under their control.

- Goods imported for humanitarian purposes, i.e. medical, surgical and laboratory equipment and other relief consignments that do not qualify for the exemption for relief consignments, should be granted temporary admission with total relief from import duties and taxes, and without the application of economic import restrictions or prohibitions;
- Temporary admission of such goods should not be subject to stricter conditions than the following:
    - In order to qualify for that exemption, the goods should be owned by a person established outside the territory of temporary admission and should be made available free of charge.
    - Medical, surgical and laboratory equipment should be intended for use by hospitals and other medical institutions which, finding themselves in exceptional circumstances, have urgent need of it, and must not be readily available in sufficient quantity in the territory of temporary admission; and
    - Relief consignments should be dispatched to persons approved by the competent authorities in the territory of temporary admission.

97. In addition to the general guidance regarding accelerated and simplified clearance, whenever possible, an inventory of the goods together with a written undertaking to re-export should be accepted for medical, surgical and laboratory equipment in lieu of a customs document and security.

98. Temporary admission of relief consignments should be granted without a Customs document or security being required. However, the Customs authorities may require an inventory of the goods, together with a written undertaking to re-export.

99. The time period for temporary admission should be determined in accordance with the needs for medical, surgical and laboratory equipment; and should be at least twelve months for relief consignments.

Principle E

> *E. It is generally considered that goods that are provided domestically to, or imported by, a foreign country, aid agency or international governmental organization for direct use in response to a humanitarian crisis, and services closely connected with such supplies, that would – if imported - qualify as "relief consignments" or "goods for humanitarian purposes" for import duty and tax exemption on temporary admission, should be relieved from domestic indirect taxes.*

100. There are currently no international standards with respect to the exemption of relief consignments from domestic indirect taxes. To avoid distortion, it would be appropriate to grant the same favorable tax treatment to relief consignments that are sourced or supplied to a

foreign country, aid agency or international governmental organization for use in response to a humanitarian crisis under the same conditions and circumstances as imported relief consignments would enjoy pursuant to the instruments discussed above.

101. Principle E therefore extends the approach of Principle D to domestic indirect taxes such as value-added taxes. Thus goods, as well as services closely connected to such goods, that are domestically provided to a foreign donor for direct use in response to a humanitarian crisis, or that are imported by a foreign donor for that purpose, should benefit from a similar exemption as regards domestic indirect taxes as long as these goods and services would – if imported – qualify as "relief consignments" or "goods for humanitarian purposes" for import duty and tax exemption on temporary admission. Such exemption from domestic indirect taxes could be achieved either on the side of the supplier (by zero-rating qualifying domestic supplies) or on the side of the purchaser (by granting refund of domestic taxes paid). From an administrative point of view, the latter method is preferred as it allows for tighter controls. Also, the foreign a country, aid agency or international governmental organization that would benefit from such an exemption from domestic indirect taxes should be identified beforehand in the same manner as beneficiaries of import duty and tax exemption for such relief consignments.

Indirect taxation – personal property and household goods of workers

Principle F

> *F. It is generally considered that personal property and household goods of workers coming to a recipient country for the purpose of an ODA project should be exempt from indirect taxes, including customs duties, as long as*
>
> *a) these workers' stay is merely temporary and is related to that project, and*
>
> *b) such property and goods are imported in the country solely for the personal use of the workers.*

102. It is an internationally recognized[35] practice not to impose import duties and taxes on personal effects of non-resident travellers subject to specified limits as to type and quantity of the goods, and the time-limit during which such goods may stay in the country concerned. This is a particular form of temporary admission. In addition, persons who move their place of residence to a country are often allowed to import their household goods into that country free of import and export duties and taxes, again subject to limitations as to type and quantity of the goods concerned;[36] that exemption is specifically recognized in various international instruments for diplomats, consular personnel and staff of international organizations.

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35 Chapter 1 on Travellers of Specific Annex J to the Revised Kyoto Convention; specific Annex B.6 of the Istanbul Convention also concerns travellers' personal effects, and Chapter 3 on Relief from Import Duties and Taxes of Specific Annex B to the Revised Kyoto Convention. With respect to household goods, the Guidelines to Chapter 3 of Specific Annex J state that there "is presently no standard set of conditions among WCO Members for granting relief", this being an area for further harmonization.

36 While virtually all countries provide for import duty and tax exemption for personal effects of non-resident travellers, only some countries grant relief in general for household goods of persons who move their residence to their territory. Often this type of exemption is limited to "returning residents", i.e. residents of the country that return to their former residence after having spent a prolonged period of time abroad.

103. The situation of non-resident workers[37] dispatched to a recipient country in the context of an ODA project does not necessarily fall into any of these broad categories of exemptions: they are not the typical tourist travellers that are primarily targeted by the former category of exemptions, they typically do not enjoy diplomatic status, and they typically do not transfer their residence to the recipient country.

104. Bilateral assistance agreements typically provide relief from import duties and taxes for personal property of workers dispatched to the recipient country in the context of projects funded under that agreement. The following is a typical example:

> The personal property of experts charged with the execution of projects and programs in the context of this agreement and who are not citizens of [the recipient country] and do not permanently reside there, is exempt from duties, taxes and other charges when imported into [the recipient country]. When such goods are transferred in [the recipient country], the excises due must be paid in accordance with the provisions in force in [the recipient country].

105. As recognized in Principle F, exempting the personal property of such workers from indirect taxes, including import duties, is justified as long as their stay is merely temporary and related to the ODA project and that such property is imported in the country solely for the personal use of the workers. This could be done subject to the following conditions:

- the scope of the exemption be defined by recourse to the internationally established notions of "personal effects" and "removable articles" that exist for travellers and persons relocating their place of residence;
- the type of taxes covered by the exemption be clearly defined by using the terminology of the country which grants the exemption, and, ideally, by individually listing the country's duties and taxes for which exemption is granted;[38]
- the beneficiaries of the exemption be clearly defined, and residents of the recipient country be denied the exemption;
- the exemption should be limited to property that will be present in the country for a predetermined time period;
- the application of temporary admission rules (notably the obligation to re-export within a predetermined time-period) be limited to specified high-value or high-risk goods (e.g., vehicles);
- in the case of vehicles, the exemption should be restricted to previously-used vehicles and should be conditional on the vehicle not being disposed of;
- the other procedures and conditions be those of similar exemptions that are well-established in the domestic legislation of the recipient country.

106. Recipient countries could incorporate this exemption along the lines of these recommendations into their domestic legislation, either indiscriminately for all personnel working under an assistance agreement or only for those who work under an assistance agreement that provides for this benefit "in accordance with the recipient country's domestic law provisions in force".

37 For this purpose, "workers" refers to employees as well as self-employed persons.

38 See e.g., paragraph 3 of Article 2(Taxes Covered) of the UN Model and the OECD Model.

Indirect taxation – temporary admission

Principle G

> *G. It is generally considered that no indirect taxes, including customs duties, should be imposed on the temporary admission of goods to be used for the purposes of an ODA project. This corresponds to the rules of*
>
> *a) Chapter 1 (Temporary Admission) of the Specific Annex G to the Revised Kyoto Convention"), and*
>
> *b) the parts of the Convention on temporary admission (commonly referred to as "the Istanbul Convention") that relate to temporary admission of certain goods.*
>
> *(Countries that are not parties to these instruments are encouraged to become parties to them or to implement the rules of these instruments)*

107. The benefits of not imposing import duties and taxes on goods which are intended to stay only temporarily and for a particular purpose in a given country are widely recognized both by traders and by customs authorities. There are strong economic, social and cultural reasons for not imposing the import duties and taxes that would otherwise be due, for instance to allow traders to test foreign goods before they decide to import them, or to stimulate exchanges in the cultural, educational and scientific area. The customs procedure that provides for relief from import duties and taxes on goods imported for a specific purpose and on the condition that they be re-exported in the same state is commonly known as temporary admission.

108. Temporary admission plays a central role in the tax treatment of ODA projects, as many of the goods that are imported for the purpose of carrying out such projects are not intended to stay in the recipient country beyond the completion of the project (e.g., construction tools and equipment imported for the purpose of carrying out a construction project).

109. Most countries have provisions on temporary admission in their domestic legislation. In addition to these domestic law provisions, a number of countries have entered into bilateral assistance agreements with donor countries, international aid organizations or other donor or aid agencies which contain provisions on temporary importation. These agreements often show differences, minor or major, between them and compared to the corresponding domestic law provisions. Furthermore, by their nature, such agreements only cover activities by the contracting donor country, organization or agency, and their facilities are thus not available to other donors. Finally, such agreements are usually not published or publicly disseminated, or at least not systematically or in the same way as ordinary tax laws and regulations, thus lacking transparency and adding complexity.

110. There are also a number of multilateral agreements and conventions regarding temporary admission. The main instruments in this respect are the previously-mentioned Istanbul Convention[39] and Chapter 1 on Temporary Admission, Specific Annex G to the

39 The Istanbul Convention combines into a single instrument all the existing provisions on temporary admission in a multitude of earlier conventions and agreements on the ATA ("ATA" is a combination of the French "*admission temporaire*" and the English "temporary admission") carnet with respect to specific types of goods. The ATA carnet system is one of the most important internationally accepted systems for the movement of goods under temporary admission through multiple Customs territories. It

Revised Kyoto Convention. The Revised Kyoto Conventions contains the basic provisions for all customs procedures, including the fundamental principles concerning temporary admission. The Istanbul Convention, on the other hand, contains more details regarding specific categories of goods, and regarding customs documents and guaranteeing associations. It is also more liberal than the Revised Kyoto Convention in that it also provides for relief from economic prohibitions and restrictions for temporary admission goods;[40] specific Annexes B.1 to E of the Istanbul Convention include the list of goods that should be granted temporary admission with total relief from duties and taxes.

111. Principle G is based on the rules of these existing international instruments. By incorporating these rules in their domestic law (either by becoming parties to the relevant instruments or by unilaterally adopting these rules by law), countries would overcome the need to enter into bilateral agreements to deal with temporary admission in the context of ODA projects which, as noted above, hamper transparency and harmonization in this area.

112. Indeed, to the extent that a recipient country would follow Principle G, there would be no need for special tax exemptions for temporary admission in an ODA agreement. Special rules could be agreed bilaterally, however, if and to the extent that a need would still exists with respect to ODA projects to deviate from the general domestic rules on temporary admission. Such special rules could, for instance, deal with specific issues relating to the carrying out of the project (e.g., usage or special categories of goods not normally allowed for temporary importation, longer time-limits during which goods are allowed to stay in the country, etc.). Alternatively, domestic law could grant customs a margin of discretion, circumscribed by the existence of an assistance agreement, to deviate on certain points from the general rules on temporary admission and subject to prior application to that effect by a qualifying importer.

relies on an international chain of guaranteeing associations that provide the security for any duties and taxes which may become liable on the temporarily admitted goods.

40 The Kyoto Convention only encourages parties to adopt "a less restrictive practice" regarding economic prohibitions or restrictions with respect to temporary admission goods.